



## State Investment Commission

### Monthly Meeting Minutes

Wednesday, October 24, 2012

9:00 a.m.

Room 135, State House

The Monthly Meeting of the State Investment Commission (SIC) was called to order at 9:03 a.m., Wednesday, October 24, 2012 in Room 135, State House.

## I. Roll Call of Members

The following members were present: Mr. Thomas Fay, Mr. Robert Giudici, Ms. Paula McNamara, Mr. Andrew Reilly, General Treasurer Gina Raimondo and Mr. Frank Karpinski. Ms. Rosemary Booth Gallogly arrived at 9:11 a.m.

Also in attendance: Mr. Thomas Lynch and Mr. Steve Nesbitt of Cliffwater, Alternative Investment Consultant to the Commission; Mr. Allan Emkin and Mr. John Burns, of Pension Consulting Alliance (PCA), General Policy Consultant to the Commission; Ms. Sally Dowling, of Adler Pollock Legal Counsel to the Commission; Mr. Charles Bauer and Mr. E. Murphy Markham IV of EnCap Investments; Kenneth Goodreau, chief investment officer and members of the Governor's, Treasurer's and Auditor General's staff.

Treasurer Raimondo called the meeting to order at 9:03 a.m.

## II. Approval of Minutes

On a motion by Mr. Fay and seconded by Mr. Reilly, it was unanimously

**VOTED: To approve the draft of the minutes of the September 26, 2012 meeting of the State Investment Commission.**

On a motion by Mr. Giudici and seconded by Mr. Fay, it was unanimously

**VOTED: To approve the draft of the minutes of the October 10, 2012 meeting of the State Investment Commission.**

## III. Alternative Consultant Recommendation

Mr. Lynch introduced Mr. Bauer and Mr. Murphy from EnCap to present EnCap Energy Capital Fund IX.

Mr. Bauer emphasized consistency of personnel, returns and strategy. He explained they have been in private equity for 25 years and gave an account of their history. He pointed out no fund has lost money and only one fund has not achieved its targeted rate of return.

EnCap has invested in about 200 companies and has turned \$4.4B into \$11.8B for a cumulative 62% gross IRR and 2.7X multiple. Out of the 200 companies only 5 of them have returned less than cost and the aggregate total of those 5 is less than \$50M. Mr. Bauer

explained they have a credit mentality and they do not use a lot of leverage for big acquisitions.

Mr. Markham took the board through the presentation starting with their track record and the track record of their portfolio companies. He made clear there have been no environmental issues with any of their companies. Mr. Markham explained Fund IX will consist of 20-25 portfolio companies and he detailed the process of investing in these companies. He pointed out EnCap does not fund exploration and only develops in areas with proven production. Their typical hold period is about 2.5-3 years and he explained how the energy opportunity has evolved over the firm's history.

Treasurer Raimondo asked about the key members of the staff and Mr. Bauer explained their financial commitment as well as their intentions to stay with EnCap for years to come.

Mr. Lynch recommended the committee invest \$20 million in Fund IX. He explained he thinks it fits our portfolio well and EnCap are a top-tier manager in the space.

Mr. Reilly and Mr. Goodreau explained our energy exposure within the private equity portfolio.

Ms. McNamara asked about the fee structure and Mr. Lynch explained it is in line with market rates.

On a motion by Mr. Fay and seconded by Mr. Reilly, it was unanimously

**VOTED: to commit \$20 million to EnCap Investments, for investment in EnCap Energy Capital Fund IX predicated on satisfactory completion of all due diligence.**

#### **IV. Hedge Fund Monitoring Process Presentation**

Mr. Nesbitt walked the group through the presentation on monitoring hedge funds and started off by reviewing the roles of the SIC, the consultant and Treasury staff. He then reviewed the overall portfolio planning process including asset allocation as well as benchmark and risk/return objectives. Mr. Nesbitt then described the tasks of manager/fund selection including investment strategies review, screening, investment due diligence, operations due diligence and legal review. He described portfolio construction tasks including return and risk objectives, manager diversification, liquidity and rebalancing.

Mr. Nesbitt then explained Cliffwater's individual manager monitoring process including manager contact, data collection, investment and performance review, operations review and exception review. Cliffwater has an analyst assigned to each manager in the portfolio and they touch base with managers at least once a month to collect portfolio information and any changes of strategy. He explained they compile an extensive list of data points relating to the underlying portfolio and summarize it in a quarterly report.

Ms. Booth Gallogly asked Mr. Nesbitt to elaborate on the legal process, more specifically regarding the regulatory environment. Mr. Lynch pointed out all managers in the portfolio are SEC registered. Mr. Nesbitt explained the process by which Cliffwater is notified of SEC inquiries.

Mr. Kem Edwards, Treasury staffer, gave a brief presentation on internal risk management processes. Mr. Goodreau pointed out that being indexed in equity allows staff to focus on monitoring other asset classes and BNY Mellon's platform should assist in analytics as well.

Ms. Anne-Marie Fink, Treasury staffer, pointed out staff will look at risk from both a qualitative and quantitative perspective. Mr. Nesbitt discussed reporting and portfolio administration. He then explained the watch list and formal process for making a manager switch and pointed out on average there is a 10% annual turnover in managers, including 2008 where there was more than usual.

## **V. Risk Management Discussion**

Treasurer Raimondo thanked the board for the feedback during the interim meeting and introduced Mr. Emkin.

Mr. Emkin reviewed the RFI review process and Ms. Fink began her presentation. She reviewed the impact of risk mitigation in five different market scenarios including status quo, low-rate policy, growth slows, growth spike and “nirvana”-a strong economy with credible deficit reduction plan. She explained non-US equity and the Russell 3000 would be very expensive to hedge so were not included in the initial analysis. The S&P 500 is more liquid, thus less expensive to hedge and is highly correlated to the Russell 3000 so the chart focused on the S&P 500. Ms. Fink then cross-referenced the scenarios with the potential hedges including a 90% S&P 500 put, a 90%/110% S&P 500 collar, a 90%/104% S&P 500 collar or a shift of 10% from equity to cash. She provided the calculated return expectations under each cross-referenced scenario.

Mr. Giudici asked about timing of the market and Ms. Fink said included in these scenarios are market-timing assumptions.

Ms. Fink pointed out given the concern about market timing, the cost of the hedges and of potential lost upside, and the math presented, it is not compelling to hedge at this time. She explained the US equity portfolio would not get enough downside protection for the expense incurred.

Treasurer Raimondo also pointed out pricing has gotten more expensive since this analysis was completed a couple days ago. Mr. Emkin agreed and said the VIX increased 20% in ten days.

The board theoretically discussed the pros and cons of moving to cash and it was determined no action would be taken on the RFI at this time.

## **VI. Legal Counsel Report**

There was no legal update.

## **VII. CIO Report**

Mr. Goodreau updated the board on the equity transition approved by the board to make the equity bucket more global. Treasury staff and Russell spearheaded the transition. He also updated the board on the fixed income transition.

## **VIII. Treasurer's Report**

Treasurer Raimondo updated the board on the first fixed income implementation and explained the first RFP will go out next week. She pointed out the custodian transition is also on track to be complete on time and on budget the night of October 31<sup>st</sup>. She said the board should get an update on real estate in the next couple months. Mr. Emkin added there will also be an infrastructure education presentation next meeting.

## **IX. Adjournment**

There being no other business to come before the Board, on a motion by Mr. Reilly and seconded by Ms. Booth Gallogly the meeting adjourned at 10:40 a.m.

Respectfully submitted,

**Gina M. Raimondo**  
General Treasurer

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